Tax Law Changes Are Needed to Improve Fairness in Paying Interest on Tax Refunds

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INSPECTOR GENERAL
for TAX
ADMINISTRATION

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MEMORANDUM FOR COMMISSIONER ROSSOTTI

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FROM: (for) Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Report - Tax Law Changes Are Needed to Improve Fairness in Paying Interest on Tax Refunds

This report presents our evaluation of the effect of changes made to the Internal Revenue Code by the Omnibus Budget Reconciliation Act of 1993 (OBRA 93)[1] as they related to the Internal Revenue Service's (IRS) payment of interest on tax refunds. We reviewed the IRS' records of interest payments for Fiscal Years (FY) 1994 through 1999 and performed detailed analyses of the $3.5 billion in interest payments made in FY 1999.

In summary, the current interest laws limit the IRS' ability to fulfill its mission to provide fairness to all taxpayers. Interest payments are determined by the method used to identify an overpayment, the method of delivering an overpayment to the taxpayer, and the type of taxpayer receiving the overpayment. Basing the computation of interest on these factors treats taxpayers inequitably, leaves the tax system open to profit-motivated manipulation, penalizes taxpayers who wish to pay future taxes with their overpayments, and produces needless complexity in interest computations. In addition, the current interest laws create a government interest expense that averages $2.6 billion annually and prevent the IRS from eliminating that expense through improved responsiveness to taxpayers.

By quickly issuing refunds requested on original returns, the IRS can avoid paying interest on the refunds resulting from original returns. However, the tax law provides the IRS with little opportunity to avoid substantial interest payments on refunds resulting from amended returns or IRS examinations of returns. Consequently, $3.2 billion of the

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[1] Pub. L. No. 103-66, § 13271, 107 Stat. 312 (1993).

$3.5 billion paid in interest in FY 1999 was related to refundable overpayments from amended returns or IRS examinations. Most ($2.2 billion) of the interest was paid to just 38 corporate taxpayers.

We recommended that the IRS seek legislation to achieve fairness in the payment of interest. Such legislation should ensure that all taxpayers receive interest if the IRS does not return their overpayment within 45 days of their requests, regardless of the method of identifying the overpayment, the use to be made of the overpayment, or the type of taxpayer receiving the overpayment. The legislation should ensure that interest starts on the date of the taxpayer's request for refund or credit of an overpayment. Interest should end on the date the overpayment is refunded or used to satisfy any past, present, or future tax debt.

The Deputy Commissioner of the IRS responded that he agreed with our concerns that the current interest rules are quite complex and that the interest of fairness is important. However, he stated that the IRS is unable to agree at this time with our recommendation because the responsibility to propose legislation is reserved to the Department of the Treasury. However, the Commissioner, Small Business/Self-Employed Division, will coordinate with the other IRS Operating Divisions, the Office of the Chief Counsel, and the Department of the Treasury to review the current interest rules. The final determination of the need for legislation stemming from that review is the responsibility of the Department of the Treasury's Assistant Secretary for Tax Policy.

Management's comments have been incorporated into the report where appropriate, and the full text of their comments is included as an appendix.

Copies of this report are being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions, or your staff may contact Gordon C. Milbourn III, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-3837.

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Executive Summary

The Congress has taken significant steps to address the issues of when, why, and how much interest should be paid to taxpayers on six occasions since 1965. In taking these steps, the Congress has attempted to provide strong incentives for the Internal Revenue Service (IRS) to minimize interest payments by issuing fast refunds. At the same time, the Congress has sought to ensure all taxpayers are fairly compensated for IRS refund delays and that taxpayers are not rewarded with often-generous government interest for intentionally delaying the refund process.

In 1991, the IRS sought equal interest payments on both original and amended returns filed by taxpayers. The IRS' proposal followed the same theme as the new IRS mission that states a commitment to "top quality service" and "fairness to all." The proposal also had the potential to encourage the issuance of faster refunds to taxpayers, thereby significantly reducing interest payments.

In response, the Congress incorporated changes to interest laws into the Omnibus Budget Reconciliation Act of 1993 (OBRA 93).[1] From Fiscal Year (FY) 1994 through FY 1999, the IRS paid $15.7 billion in interest based upon the revised interest laws.

Our audit objective was to evaluate the effect of changes made to the Internal Revenue Code (I.R.C.) by the OBRA 93 as they related to the IRS' payment of interest on tax refunds. We reviewed the IRS' records of interest payments for FYs 1994 through 1999 and performed detailed analyses of the $3.5 billion in interest payments made in FY 1999. Most ($2.2 billion) was paid to just 38 corporate taxpayers that received interest ranging from over $10 million to over $675 million.

Results

Current interest laws limit the IRS' ability to carry out its mission to provide top quality service and fairness to all taxpayers. Interest payments are determined by the method used to identify an overpayment, the method of delivering an overpayment to the taxpayer, and the type of taxpayer receiving the overpayment. Basing the computation of interest on these factors treats taxpayers inequitably, leaves the tax system open to profit-motivated manipulation, penalizes taxpayers who wish to pay future taxes with their overpayments, and produces needless complexity in interest computations. In addition, the current interest laws create a government interest expense that averages

[1] Pub. L. No. 103-66, § 13271, 107 Stat. 312 (1993).

$2.6 billion annually and prevent the IRS from eliminating that expense through improved responsiveness to taxpayers.

Simplifying Interest Laws Could Improve Fairness, Speed Refunds, and Reduce Annual Government Interest Costs by $2.6 Billion

The Congress has long sought to fairly compensate taxpayers for IRS refund delays while deterring taxpayers from abusing the tax system to receive interest from the IRS, which is sometimes greater than interest available on other investments in the public sector. To accomplish these goals, the Congress has targeted various types of refunds and groups of taxpayers with different interest computations and interest rates.

The OBRA 93 contained the last major revisions of the interest laws that determine whether interest will be paid and, if so, for what time period. However, the revisions did not change interest payment laws to achieve fairness for all taxpayers.

Basing interest on the method of identifying an overpayment prevents fairness and simplicity

Original returns, amended returns, and IRS examinations are all methods of arriving at the proper tax and identifying overpayments or underpayments. Although any of these three methods could be used to identify the same overpayment, determining the length of time for which interest is paid differs for each method. Depending upon the method used, the taxpayer may receive no interest or may receive many years of interest on any overpayment.

Current interest laws prohibit the IRS from paying interest on refunds issued within 45 days of an original return filing but require the IRS to pay up to 3 years of interest on refunds from amended returns. Significantly more than 3 years of interest may be required when the IRS examines a return.

Of the 38 corporations that received interest payments of more than $10 million in FY 1999, 36 received a total of $1.8 billion of interest as a result of IRS examinations. The IRS paid an average of 10.5 years of interest on the overpayments resulting from these examinations. The $1.8 billion paid to these 36 corporations represented 51 percent of the $3.5 billion of total interest paid to all taxpayers in FY 1999.

Basing interest on the method of delivering an overpayment to the taxpayer prevents fairness and simplicity

If the IRS delays the proper disposition of overpayments, taxpayers receiving refunds will be compensated with interest according to the OBRA 93. However, a pre-OBRA 93 I.R.C. provision can reduce or eliminate the interest based upon how the overpayment is used. The interaction of this interest law with the OBRA 93 interest laws produces 15 scenarios for any overpayment that must be considered to determine whether, and for what time period, interest applies. Such complexity in computing interest impairs fairness both in appearance and in practice.

For example, a taxpayer entitled to interest on a refund because of IRS delays will not receive the interest if the taxpayer elects to have the money used to pay taxes not yet due for the succeeding tax year. The taxpayer may also lose the interest if the money is used to pay the taxpayer's own current tax debts. However, the taxpayer will not lose the interest if the money is used to pay the tax debts of another taxpayer.[2]

Basing interest rates on the type of taxpayer prevents fairness and simplicity

Interest rates paid to corporations are lower than both the rates they must pay on their tax debts and the rates the IRS pays to all other taxpayers. These lower rates were established to ensure that interest rates paid by the IRS did not encourage profit-motivated changes to taxpayer payment or filing behavior. Although corporations receive the majority of the interest paid by the IRS ($3.0 billion of the $3.5 billion paid in FY 1999), the extent of profit-motivated activity is unknown, and some leading corporate tax professionals believe the lower rates are an unwarranted penalty on corporations.

In addition, the separate rates for corporations further complicate interest computations. The separate rates, in conjunction with the methods of overpayment identification and delivery, create 30 different scenarios that the IRS must consider to determine whether and how much interest applies to any overpayment.

Basing interest payments on taxpayer and IRS responsibilities can ensure fairness and simplicity

Revisions to interest laws based upon the Congressional trend emphasizing taxpayer and IRS responsibilities could provide fairness for all taxpayers, eliminate the potential for profit-motivated abuse of the refund process, and simplify interest computations. This could be accomplished by basing interest payments upon both the timely fulfillment of the taxpayer's responsibility for notifying the IRS that an overpayment exists and the IRS' responsibility for responding timely to the taxpayer's instructions regarding the proper disposition of the overpayment.

If the IRS followed a taxpayer's instructions for returning an overpayment within 45 days, no interest would be paid. Otherwise, the IRS would compensate the taxpayer with interest for the time it takes to carry out the taxpayer's instructions. Under these conditions, interest computations would be simplified, taxpayers would be fairly compensated for IRS delays, and taxpayers would not be guaranteed interest if they intentionally delayed refund requests. Since interest payments would result only from IRS delays, the IRS could be held accountable for all interest paid. All interest payments

[2] An example of this would be a parent corporation paying the debts of a subsidiary corporation.

could be eliminated if accountability for interest prompted the IRS to timely resolve all taxpayer claims.

Summary of Recommendations

We recommend that the IRS Commissioner propose new interest laws that are based upon the timely fulfillment of taxpayer and IRS responsibilities. The IRS should be responsible for paying interest on any overpayment not returned within 45 days in the manner requested by the taxpayer. Interest should be paid from the date of the taxpayer request to the date the money is returned to the taxpayer. Successful implementation of such simplified interest laws would provide the IRS with the opportunity to eliminate $2.6 billion in interest annually.[3]

Since enactment of this legislation would deter profit-motivated refund delays, lower corporate interest rates will no longer be needed for this purpose. Therefore, we also recommend that the IRS Commissioner propose legislation that will require the same rate of interest be paid to all taxpayers. These two legislative proposals will provide the IRS the opportunity to carry out its mission to provide top quality service and fairness to all taxpayers in the payment of interest.

<u>Management's Response</u>: The Deputy Commissioner of the IRS responded that he agreed with our concerns that the current interest rules are quite complex and that the interest of fairness is important. However, he stated that the IRS is unable to agree at this time with our recommendation because the responsibility to propose legislation is reserved to the Department of the Treasury. However, the Commissioner, Small Business/Self-Employed Division, will coordinate with the other IRS Operating Divisions, the Office of the Chief Counsel, and the Department of the Treasury to review the current interest rules. The final determination of the need for legislation stemming

[3] This estimate is based on the average amount of interest paid by the IRS over a 6-year period and represents the amount that could be avoided if all overpayments are timely refunded by the IRS within 45 days. Therefore, the actual interest savings would be reduced by an indeterminable amount for any refunds that are not timely processed.

from that review is the responsibility of the Department of the Treasury's Assistant Secretary for Tax Policy.

Management's complete response to the draft report is included as Appendix V.

Objective and Scope

This audit addressed the impact of the OBRA 93 legislation on the IRS' payment of interest on tax refunds.

Our audit objective was to evaluate the effect of changes made to the Internal Revenue Code (I.R.C.) by the Omnibus Budget Reconciliation Act of 1993 (OBRA 93)[1] as they related to the Internal Revenue Service's (IRS) payment of interest on tax refunds. We focused our analyses on Fiscal Year (FY) 1999, during which the IRS paid a total of $3.5 billion in interest.

To accomplish this objective, we computer-analyzed information from the IRS' Masterfile[2] and reviewed the IRS' internal management reports regarding tax refunds and related interest transactions occurring during FY 1999.[3] We reviewed the IRS records that formed the basis for the OBRA 93 legislation and studied the legislative history of the interest provisions. We also researched the provisions of the I.R.C., Treasury Regulations, Revenue Rulings, Congressional reports, and Chief Counsel opinions regarding the payment of interest.

We conducted our review from June 2000 through February 2001 in accordance with *Government Auditing Standards*. We did not test management controls since they were not significant to our audit objective. Details of our audit objective, scope, and methodology are presented in Appendix I. Major contributors to this report are listed in Appendix II.

[1] Pub. L. No. 103-66, § 13271, 107 Stat. 312 (1993).
[2] The Masterfile is the IRS' main computer system, containing taxpayer accounts.
[3] For the purposes of this audit, we assumed that the taxpayer account information and the management information reports on interest payments maintained by the IRS were accurate.

Background

The Congress establishes the laws that the IRS must strictly follow in determining whether interest must be paid to taxpayers on overpayments of taxes and, if so, how much interest must be paid. These laws are contained in I.R.C. Section 6611. As a result of the IRS' efforts, the Congress last addressed the events that start and stop interest payments with the enactment of the OBRA 93.

In 1991, the IRS Inspection Service (now the Treasury Inspector General for Tax Administration) reported[4] that the amount of interest payments on tax refunds had increased from $1.7 billion in FY 1988 to $2.4 billion in FY 1990 – a 41 percent increase. The report recommended that amended returns be treated the same as original returns for interest purposes. As a result of this report, the IRS submitted a legislative proposal later that year to prohibit interest on refunds from amended returns when the refunds were issued within 45 days of the IRS' receipt of the amended return. The IRS' proposal followed the same theme as the new IRS mission that states a commitment to "top quality service" and "fairness to all." The proposal also had the potential to encourage the issuance of faster refunds to taxpayers, thereby significantly reducing interest.

Legislation was subsequently introduced into the Congress in 1992 to eliminate interest on refunds made within 45 days of filing amended returns. In August 1993, the Congress passed changes to interest rules into law as part of the OBRA 93.

[4] *An Analysis of Interest Paid on Tax Refunds* (Reference Number 01243, dated March 11, 1991).

Results

Current interest laws limit the IRS' ability to provide fairness to all taxpayers when paying interest, and interest payments continue to rise.

Current interest laws limit the IRS' ability to carry out its mission to provide top quality service and fairness to all taxpayers, and interest payments continue to rise. According to IRS records, 28 percent more interest was paid on refunds in FY 1999 than in FY 1993. From FY 1994 through FY 1999, the IRS paid $15.7 billion in interest on tax refunds despite interest savings of $0.6 billion that were attributable to the OBRA 93 interest law changes. Most of the $2.6 billion in average annual interest was paid for time periods prior to the IRS' knowledge that refundable overpayments existed.

The amount of interest, if any, paid to a taxpayer is determined by a number of factors that have little to do with when the IRS became aware of an overpayment or how quickly it acted to return the money to the taxpayer. Major factors in interest determinations include the method used to identify an overpayment, the method of delivering an overpayment to the taxpayer, and the type of taxpayer receiving the overpayment.

Basing the computation of interest on these factors treats taxpayers inequitably. In addition, it leaves the tax system open to profit-motivated manipulation, penalizes taxpayers who wish to pay existing or future taxes with their overpayments, and prevents the IRS from saving $2.6 billion in interest annually by quickly returning overpayments to taxpayers.[5]

[5] This estimate is based on the average amount of interest paid by the IRS over a 6-year period and represents the amount of interest that could be avoided if all overpayments are timely refunded by the IRS within 45 days. Therefore, the actual interest savings would be reduced by an indeterminable amount for any refunds that are not timely processed.

Simplifying Interest Laws Could Improve Fairness, Speed Refunds, and Reduce Annual Government Interest Costs by $2.6 Billion

The Congress has long sought to fairly compensate taxpayers for IRS refund delays, while deterring taxpayers from using the tax system to intentionally receive government interest, which is sometimes greater than interest available on investments in the public sector. To accomplish these goals, the Congress has targeted various types of refunds and groups of taxpayers with different interest computations and interest rates.

Just 38 corporate taxpayers received 63 percent of the total interest paid by the IRS in FY 1999.

In accordance with current interest laws, the IRS was required to pay $3.5 billion in interest on overpayments in FY 1999. Of this amount, $1.3 billion was paid to 4.8 million business and individual taxpayers. The business taxpayers received an average of $812 each, and the individual taxpayers received an average of $85 each. The remaining $2.2 billion (63 percent) was paid to 38 corporations. The interest payments to these 38 corporations ranged from over $10 million to over $675 million and averaged over $58 million each.

Basing interest on the method of identifying an overpayment prevents fairness and simplicity

Through changes to the interest laws contained in the I.R.C., the Congress has sought to fairly compensate taxpayers for IRS delays in issuing refunds. In determining fair compensation for delays, the Congress has increasingly emphasized taxpayer responsibility for the timing of refund requests and IRS responsibility for fast refund issuance. The length of time the government is in possession of the money being refunded has been increasingly de-emphasized by the Congress since 1966.

In 1965, the General Accounting Office (GAO) reported[6] that excessive interest costs arose when taxpayers had the ability to delay filing an original tax

[6] S. Rep. No. 1709, 89th Cong., 2d Sess., 2 (1966).

return until it was impossible for the IRS to issue a refund without paying interest. In 1966, the Congress responded by changing the interest laws to prohibit the payment of interest on a late-filed return if the refund was issued within 45 days of the IRS receiving the return.

This 1966 legislation[7] was the beginning of a Congressional trend that has placed increasing emphasis on taxpayer and IRS responsibilities, rather than payment dates, as the major factors in determining interest entitlement. Prior to 1966, it had been commonly accepted that, except for payments made before the due date of a return, the taxpayer was entitled to interest for the period of time that the government had use of the taxpayer's money. The 1966 legislation was the first major departure from this view because it established that the taxpayer's actions could void this commonly accepted interest entitlement.

The Congress has continued to shift its focus away from paying interest based on the length of time that money is in the government's possession.

The 1966 legislation still required the IRS to pay interest starting at the return due date if a refund on a late-filed return was not issued within 45 days. This was changed in 1982 when the Congress asserted that no interest should be paid for any time prior to the taxpayer's request for the refund. Also in 1982, the Congress mandated that interest entitlement on a refund created for a past year by a current year return did not begin until the taxpayer filed a refund request for the past year. Both of these actions ignored the number of years that the government had possession of the funds.

The Committee on Finance of the United States Senate explained its reasons for the changes in a report on the Tax Equity and Fiscal Responsibility Act of 1982[8] that stated:

> *The committee believes that it is inappropriate to require that the United States pay interest on amounts prior to the time it has notice that it*

[7] Pub. L. No. 89-721, § 1, 80 Stat. 1150 (1966).
[8] S. Rep. No. 97-494 Vol. 1, 97th Cong., 2d Sess., 307 (1982). See also Pub. L. No. 97-248, § 346, 96 Stat. 636 (1982).

> *owes such an amount. Thus, no interest is payable with respect to an overpayment until the Secretary can determine that such an overpayment exists.*

With the OBRA 93, the Congress extended to all *original* returns, not just *original income tax* returns, the 1982 reasoning that interest entitlement begins with the date of the refund request, not with the date of payment. This action saved $79 million in interest in FY 1999 because the IRS issued 80 percent of the refunds covered by the new interest rule within 45 days.

However, the OBRA 93 did not extend the same reasoning to refunds resulting from amended returns or IRS examinations. By including different interest provisions for different refund request methods, the new law limited the IRS' ability to provide fairness to all taxpayers when determining the length of the interest computation period.

Original returns, amended returns, and IRS examinations of returns are all methods of arriving at the proper tax and identifying an overpayment or underpayment. *Tax laws*, other than those resulting from the OBRA 93, establish that any original return, amended return, or IRS examination that determines a proper tax amount and identifies an overpayment represents a refundable tax return.[9] However, current *interest laws* require that taxpayers be paid different amounts of interest depending upon which type of refundable tax return is used to initiate a refund.

A taxpayer may receive no interest or may receive many years of interest depending upon the method used to identify the taxpayer's overpayment. For example, taxpayers can normally request a refund from the IRS up to 3 years from the tax return due date. Sometimes the IRS is authorized to issue such refunds interest-free. In

[9] E.g., 26 U.S.C. § 6213 (g)(1) (2000), 26 C.F.R. § 301.6402-2(a)-(c) (2000), 26 C.F.R. § 301.6402-3(a)(5) (2000), Rev. Rul. 68-65, 1968-1 C.B. 555, Rev. Rul. 74-203, 1974-1 C.B. 330.

other cases, the IRS must pay interest for the entire 3-year period.

The laws are different for paying interest on tax refunds resulting from original-filed returns and amended returns.

If a taxpayer files an *original* tax return 3 years after it is due, the IRS can issue a refund completely interest-free within 45 days of receiving the return. In contrast, if a taxpayer files an *amended* return 3 years after the original return was filed, the taxpayer must be paid interest on any overpayment for the 3-year period, even if the IRS immediately issues a refund check.

The IRS' examination process can create further imbalances in interest computation time periods by extending the interest payment period well beyond the normal 3-year limit. If a taxpayer whose return is being examined agrees to allow the IRS additional time to complete the examination, the interest time period is also extended. This can result in large interest payments that cover many years.

Taxpayers whose taxes are reduced as the result of IRS examination of their returns may receive interest covering many years.

Of the 38 corporations that received interest payments of $10 million or more in FY 1999, 36 received a total of $1.8 billion of interest as a result of IRS examinations. The IRS paid an average of 10.5 years of interest on the overpayments resulting from these examinations. The $1.8 billion paid to these 36 corporations represented 51 percent of the $3.5 billion of total interest paid to all taxpayers by the IRS in FY 1999.

In total, taxpayers whose overpayments were identified by IRS examinations or amended returns received $3.2 billion of the total $3.5 billion of interest paid by the IRS in FY 1999. In contrast, taxpayers claiming overpayments on original tax returns received only $0.1 billion of the interest paid in FY 1999. Interest was paid on only 2 percent of the original refund returns filed in FY 1999.

Basing interest on the method of delivering an overpayment to the taxpayer prevents fairness and simplicity

Once it is established that a taxpayer has overpaid on an account, the IRS will automatically use the overpayment to pay any existing tax debts of the taxpayer. Once all existing tax debts are satisfied, the taxpayer can choose to receive a refund check or to have the overpayment credited to other IRS accounts.

If the IRS has delayed the proper disposition of an overpayment, a taxpayer receiving a refund will be compensated with interest according to the interest laws passed as part of the OBRA 93. However, the interest calculated using the OBRA 93 laws can be reduced or completely eliminated by one sentence in I.R.C. Section 6611(b)(1) that was not addressed by the OBRA 93.[10]

This sentence requires that, for interest purposes, overpayments applied to other IRS accounts be treated different from overpayments that are refunded. Because of this distinction, determining whether and how much compensation taxpayers will receive for IRS delays is a complicated process.

The amount of interest paid by the IRS depends on how the tax refund is being used by the taxpayer.

Due to the legal interpretation of this sentence, the amount of interest paid (if any) now depends upon whether an overpayment is used to:

- Satisfy a debt that existed before the overpayment arose.
- Satisfy a debt created after the overpayment arose.
- Satisfy tax debts of a different taxpayer.
- Pay taxes that are not yet due.
- Generate a refund.

These 5 factors, when combined with the 3 interest categories created by the OBRA 93 (i.e., original return, amended return, or IRS examination), create 15 possible scenarios that must be explored to determine whether, and for what period of time, interest will be paid to a

[10] 26 U.S.C. § 6611(b)(1) (2000) explains the time period for which interest will be paid on credits as follows: "In the case of a credit, from the date of the overpayment to the due date of the amount against which the credit is taken."

taxpayer for any given overpayment. Such complexity in computing interest impairs fairness both in appearance and in practice.

Taxpayers whose overpayments are either refunded or used to pay the tax debts of other taxpayers are fully compensated with interest for IRS delays. However, the taxpayers may lose part or all of the interest if their overpayments are used in other ways that are completely unrelated to IRS delays.

Taxpayers do not receive interest if they elect to apply their overpayments toward taxes not yet due for the succeeding year.

For example, a taxpayer entitled to interest on a refund because of IRS delays will not receive the interest if the money is used instead to pay taxes not yet due for the succeeding tax year. Taxpayers also lose part or all of their compensation for IRS delays if they owe taxes for a different tax period.

Basing interest compensation for IRS delays upon the ultimate use of an overpayment impairs fairness. It can also cause needless monetary outflows from the Department of the Treasury in the form of refunds to taxpayers who have recurring tax liabilities. In FY 1999, the IRS refunded $17 billion in overpayments and related interest. Some taxpayers, particularly large corporate taxpayers with sizable recurring tax bills, may have chosen to leave their overpayments on deposit with the Department of the Treasury as payments of future taxes if they did not risk losing interest to which they were otherwise entitled.

<u>Basing interest rates on the type of taxpayer prevents fairness and simplicity</u>

The Congress has also sought to prevent taxpayers from delaying refund requests in order to receive government interest, which is sometimes greater than that available on investments in the public sector. On average, the interest rates paid to non-corporate taxpayers between Calendar Years 1994 and 1999 exceeded the yield on 3-year Treasury Notes by over 30 percent.

The Congress specifically addressed concern over the impact of interest rates on taxpayer behavior in 1986 when it stated:

> *...either the rate taxpayers pay the Treasury or the rate the Treasury pays taxpayers is necessarily out of line with general interest rates in the economy. This distortion may cause taxpayers...to overpay to take advantage of an excessively high rate.*[11]

Although the IRS later sought legislation to prevent filers of amended returns from intentionally taking advantage of generous government interest rates, the resulting OBRA 93 changes did not deter such conduct. Taxpayers who intentionally delay their request for refunds on amended returns can still receive up to 3 years of interest.

In 1994, the Congress began to concentrate on the control of corporate interest rates to reduce the risk that taxpayers would intentionally take advantage of generous government interest. As the reason for reducing interest rates for corporate taxpayers, the Congress echoed its 1986 statement:

> *Distortions may result if the rates of interest in the Code differ appreciably from market rates. Reducing the overpayment rate for large corporate overpayments of taxes will reduce the possibility of distortions.*[12]

The Congress has lowered the interest rates paid to corporate taxpayers on overpayments of taxes to deter them from manipulating the refund process.

Beginning in 1995, the interest rate paid to corporations on amounts over $10,000 was reduced by 1.5 percent.[13] To demonstrate the impact of this change, an individual or non-corporate business taxpayer receiving a late $100,000 refund in September 1995 would have received 8 percent interest on the entire refund amount. However, a corporate taxpayer would have received 8 percent interest on the first $10,000, but only 6.5 percent on the remaining $90,000.

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[11] S. Rep. No. 99-313, 99th Cong., 2d Sess., 184 (1986). See also Pub. L. No. 99-514, § 1511, 100 Stat. 2744 (1986).
[12] H. Rep. No. 103-826 pt. 1, 103d Cong., 2d Sess., 178 (1994).
[13] Pub. L. No. 103-465, § 713, 108 Stat. 5001 (1994).

In 1998, the Congress continued its efforts to deter corporate manipulation of the refund process when it maintained lower interest rates paid to corporations, while raising the rates paid to all other taxpayers.[14] For all but corporate taxpayers, the interest rates paid to taxpayers are the same as those charged to taxpayers for underpayments of taxes.

The combination of low interest rates paid to corporations and high interest rates charged to corporations produces a sizable imbalance. In the last quarter of FY 1999, the interest rate the IRS paid on large corporate overpayments was 5.5 percent, while the rate the IRS charged on large corporate underpayments was 10 percent. Non-corporate taxpayers received 8 percent interest on their overpayments and paid 8 percent interest on their underpayments.

The IRS paid $2.2 billion in interest to just 38 corporate taxpayers in FY 1999.

Despite such a sizable imbalance in interest rates, corporate taxpayers received $3.0 billion of the $3.5 billion of interest paid to all taxpayers in FY 1999. Thirty-eight corporations received $2.2 billion of the $3.0 billion.

The IRS' records do not provide a means to differentiate interest payments resulting from intentional taxpayer delays, unintentional taxpayer delays, or IRS delays. Therefore, the portion of interest payments, if any, attributable to intentional corporate manipulation of the refund process is unknown.

Also unknown is the success of the corporate interest rate reductions in deterring such manipulation. Some leading corporate tax professionals believe there is no motivation for corporations to manipulate the refund process and view the disparity in interest rates between overpayments and underpayments as an unwarranted penalty.

In addition, separate interest rates for corporate and non-corporate taxpayers further complicate interest computations. The separate rates, in conjunction with

[14] Pub. L. No. 105-206, § 3302, 112 Stat. 685 (1998).

the methods of overpayment identification and delivery, create 30 different scenarios that the IRS must consider to determine whether and how much interest applies to any overpayment.

Basing interest payments on taxpayer and IRS responsibilities can ensure fairness and simplicity

The incentive to delay refund requests can be removed without relying on unequal interest rates or on interest calculations based on the method of identifying an overpayment or the ultimate use of the overpayment. This could be accomplished by pursuing the Congressional trend related to interest payments that has been growing since 1966.

Prior to 1966, the IRS was responsible for paying interest on any tax return refund issued more than 45 days after the tax return due date. Taxpayers were compensated with interest for the time the government had use of the taxpayer's money after the due date. In 1966, the Congress established that taxpayer delays could result in the loss of this interest.[15]

This 1966 action was taken to deter taxpayers from intentionally delaying refund requests to profit from government interest. The same problem prompted further interest law changes in 1982[16] and 1993.[17] Increasingly, the Congress sought to eliminate interest for periods during which the taxpayer, not the IRS, was responsible for the time the government was in possession of the taxpayer's money.

As previously stated, the Committee on Finance of the United States Senate best explained the concept in a 1982 report:[18]

> *The committee believes that it is inappropriate to require that the United States pay interest on*

[15] Pub. L. No. 89-721, § 1, 80 Stat. 1150 (1966).
[16] Pub. L. No. 97-248, § 346, 96 Stat. 636 (1982).
[17] Pub. L. No. 103-66, § 13271, 107 Stat. 312 (1993).
[18] S. Rep. No. 97-494 Vol. 1, 97th Cong., 2d Sess., 307 (1982). See also Pub. L. No. 97-248, § 346, 96 Stat. 636 (1982).

> *amounts prior to the time it has notice that it owes such an amount. Thus, no interest is payable with respect to an overpayment until the Secretary can determine that such an overpayment exists.*

This statement recognizes that the IRS cannot fulfill its responsibility to quickly return money to a taxpayer until it knows that there has been an overpayment. The statement also implies that it is the taxpayer's responsibility to inform the IRS that an overpayment exists, so no interest entitlement exists until the IRS is notified.

These concepts, universally applied, would produce interest fairness and simplification in the payment of interest. Interest payments could be based upon both the timely fulfillment of the taxpayer's responsibility for notifying the IRS that an overpayment exists and the IRS' responsibility for responding timely to the taxpayer's instructions regarding the proper disposition of the overpayment. If the IRS timely follows the taxpayer's instructions for returning an overpayment, no interest should be paid. However, if the IRS delays in carrying out the taxpayer's instructions, interest should be paid from the date the taxpayer notified the IRS of the overpayment to the date the overpayment is returned to the taxpayer.

These concepts could be applied equally to any and all overpayments, regardless of such considerations as the method of identifying an overpayment, the intended use of the overpayment, or the characteristics of the taxpayer. As a result, all interest paid would be solely the result of IRS delays. Not only would IRS accountability for all interest payments provide the IRS with additional incentives to quickly resolve taxpayer claims, it would provide the IRS with an opportunity to eliminate all interest payments. Further, the need to vary interest rates to discourage profit-motivated abuse of the refund process would be eliminated because interest would no longer be guaranteed for taxpayers intentionally delaying refund requests.

Recommendations

1. The IRS Commissioner should propose legislation regarding the payment of interest that will provide for equal treatment for all taxpayers and place responsibility for all interest paid on the IRS, thus providing the IRS with the ability to eliminate $2.6 billion in interest payments annually through timely processing. This proposed legislation should:

   A. Require the same treatment for all taxpayer-initiated and IRS-initiated refunds and credit transfers of taxpayer overpayments.

   B. Require the same interest treatment for any type of overpayment, whether arising from reductions in taxes, interest, penalties, or excess payments of any type.

   C. Require that interest determinations are independent of the ultimate use of the funds. For example, interest should be paid for all IRS delays regardless of whether the taxpayer elects to accept the overpayment as a refund or as a credit against current or future taxes. Interest should never be removed or denied because of the ultimate use of the overpayment or the interest.

   D. Specify the events that begin and end the interest computation period.

The financial incentives for taxpayers to delay refund requests should be removed.

      1) For refunds made more than 45 days after the taxpayer claim date, interest should be computed starting on the taxpayer claim date and ending on the refund date (minus up to 30 days, as provided by I.R.C. Section 6611(b)(2)).

      2) For overpayments credited more than 45 days after the claim date to pay existing tax, penalty, or interest debts or estimated future taxes, interest should be computed starting on the taxpayer claim date and

ending on the date the overpayment is credited to the current or potential future tax debt.

Interest should not be paid unless the IRS delays issuing a refund.

3) No interest should be paid on refunds or credit applications made within 45 days of the taxpayer claim date.

E. Define "claim dates" for various types of refund requests, particularly those for overpayments not specifically requested by taxpayers.

1) For refunds resulting from taxpayer-initiated tax abatements (e.g., original and amended returns, and claim forms that affect tax), the IRS received date should be deemed the claim date.

The interest laws should be simplified to treat refunds resulting from original returns, amended returns, and IRS examinations the same way.

2) For refunds resulting from tax abatements determined by the IRS during examinations, the date the taxpayer signs the examination agreement should be deemed the claim date.

3) For refunds resulting from reversals of IRS-induced payments (e.g., advance payments of IRS-proposed deficiencies, reversals of examination assessments, and abatements of interest or penalties), the payment date should be deemed the claim date. This would reflect the implied desire of the taxpayer to have funds returned if a payment the IRS solicited proves unnecessary.

4) For all other IRS-initiated refunds (e.g., refunds following the IRS' correction of tax returns during processing), the date that the overpayment is created on the taxpayer's account should be deemed the claim date.

2. The IRS Commissioner should propose legislation that will require the same rate of interest be paid to all taxpayers. This will ensure that taxpayers are compensated equally for IRS delays.

Management's Response: In response to both recommendations, the Deputy Commissioner of the IRS stated that the Commissioner, Small Business/ Self-Employed Division, will coordinate with the other IRS Operating Divisions, the Office of the Chief Counsel, and the Department of the Treasury to review the current interest rules. The final determination of the need for legislation stemming from that review is the responsibility of the Department of the Treasury's Assistant Secretary for Tax Policy.

Conclusion

The Congress has long sought to fairly compensate taxpayers for IRS refund delays while deterring taxpayers from using the tax system to receive government interest. The IRS sought legislation that would help achieve these goals, but the OBRA 93 interest law changes that resulted fell short of the IRS' hopes.

The OBRA 93 provisions for paying interest on tax refunds do not allow the IRS to treat all taxpayers fairly.

Current interest laws are complex and inconsistent and limit the IRS' ability to provide top quality service and fairness to all taxpayers. In addition, the laws reward taxpayers with government interest for intentionally delaying refund requests. Corporations, which receive the majority of interest paid by the IRS, receive lower interest rates to curb profit-motivated abuse of the IRS' refund process. However, the extent to which corporations intentionally delay refund requests is unknown.

These problems can be overcome by basing interest payments on the Congressional trend of emphasizing taxpayer and IRS responsibilities in the refund process. Under these conditions, fairness could be achieved and all interest paid would be solely the result of IRS delays. Accountability for all interest would not only provide the IRS with an incentive to quickly resolve taxpayer claims, but also provide the IRS with an opportunity to eliminate $2.6 billion in interest payments annually.

Appendix I

Detailed Objective, Scope, and Methodology

Our audit objective was to evaluate the effect of changes made to the Internal Revenue Code (I.R.C.) by the Omnibus Budget Reconciliation Act of 1993 (OBRA 93)[1] as they related to the Internal Revenue Service's (IRS) payment of interest on tax refunds.

To accomplish this objective, we:

I. Researched the history, nature, and scope of the OBRA 93 changes to interest payment laws present in I.R.C. Section 6611(e).

   A. Compared the pre-OBRA 93 language of I.R.C. Section 6611(e) to the post-OBRA 93 language to determine the nature of changes made by the OBRA 93.

      1. Researched provisions of the I.R.C., Treasury Regulations, Chief Counsel decisions, and internal IRS reports to determine the legal definitions of returns, amended returns, and claims needed to evaluate the nature of the OBRA 93 changes to I.R.C. Section 6611(e).

         Identified conflicts between the pre-OBRA 93 and the post-OBRA 93 I.R.C. language and between the post-OBRA 93 I.R.C. language and the Congressional Committee report that accompanied the OBRA 93.

      2. Secured and reviewed correspondence between the IRS' Submission Processing function, Customer Service function, and the Chief Counsel regarding the IRS' origins, Congressional modifications, the IRS' interpretation, and the IRS' implementation of changes to interest laws made to I.R.C. Section 6611(e) by the OBRA 93.

      3. Discussed with Chief Counsel for the Treasury Inspector General for Tax Administration (TIGTA) the IRS Submission Processing function's assertion that changes made to I.R.C. Section 6611(e) required that the IRS discontinue interest payments on amended returns.

         Obtained a TIGTA Counsel opinion regarding the OBRA 93 changes to I.R.C. 6611(e).

[1] Pub. L. No. 103-66, § 13271, 107 Stat. 312 (1993).

II. Evaluated the economic impact of the IRS' implementation of the OBRA 93 changes to I.R.C. Section 6611(e).

A. Analyzed trends in interest payments by securing and reviewing the IRS' Net Tax Refund Analysis Report, Revenue Accounting Control System Report 050, Nationwide Consolidated Interest Report for Fiscal Years (FY) 1994 through 1999.

1. Determined the cost savings produced by the OBRA 93 by identifying the impact of the OBRA 93 provisions on applicable categories of refunds on the Net Tax Refund Analysis Report.

   For our estimation of the OBRA 93 interest reductions, we assumed that the IRS took full advantage of all savings opportunities provided by the OBRA 93.

B. Obtained Internal Revenue Bulletins containing historical interest rates paid by the IRS and compared the rates to Federal Reserve Board records of interest yields on 3-year Treasury Notes to evaluate the investment value of interest rates paid by the IRS when compared to alternative low-risk investments.

C. Secured an IRS Masterfile[2] extract of 42,093,624 transactions, including all 1,842,775 interest payments credited to 1,307,452 business taxpayer accounts during FY 1999, and all 4,317,688 interest payments credited to the accounts of 3,646,781 individual taxpayers during FY 1999. We designed computer programs that:

1. Eliminated from our review 217,910 interest payments made to 195,208 taxpayers whose FY 1999 interest was reversed in FY 1999 by interest cancellations, whether directly related to a FY 1999 interest payment or related to a prior year interest payment.
2. Identified account activity specifically related to the FY 1999 interest payments, including cancellations of specific FY 1999 interest payments; abatements of tax, penalty, and interest; and refunds and transfers to other accounts of the same taxpayers.
3. Provided totals of all interest and related account activity by the type of tax involved.
4. Provided totals of all interest and related account activity stratified by the total amount of interest paid to taxpayers (e.g., totals for taxpayers receiving less than $10 million in interest in FY 1999 and taxpayers receiving over $10 million in interest in FY 1999).

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[2] The Masterfile is the IRS' main computer system, containing taxpayer accounts.

5. Provided totals of all interest and related account activity by the type of tax transaction creating the refundable credit upon which interest was paid (e.g., totals related to non-examination tax adjustments, totals related to IRS examination tax adjustments).

D. Determined the total amount of interest related to examination abatements or amended returns.

1. Determined the total interest for payments of over $1 million each that were related to examination abatements or amended returns.

   a) Obtained IRS Masterfile transcripts on all individual interest payments in excess of $1 million that were not computer-matched to tax change transactions that caused the payment of the interest in FY 1999.

      Reviewed the transcripts to manually determine how much interest was related to examination abatements or amended tax returns but was not computer-matched.

   b) Combined computer-matched interest payments with interest payments manually verified through transcript reviews as being related to examination abatements or amended returns.

2. Estimated the total amount of interest from individual payments of less than $1 million that related to examination abatements and amended returns.

   a) Applied to non-computer-matched payments under $1 million the percent of non-computer-matched items of over $1 million each that were verified by transcript review as related to examination abatements or amended tax returns. This provided an estimate of the number of non-computer-matched items that could be expected to be related to examination abatements or amended returns.

   b) Determined the average interest amount from under $1 million non-computer-matched interest payments related to examination abatements or amended tax returns.

   c) Applied the average interest amount to the estimated number of examination abatements and amended returns that were not computer-matched. This provided an estimate of the number of non-computer-matched items that could be expected to be related to examination abatements or amended returns.

d) Combined computer-matched interest payments with interest payments estimated as being related to examination abatements or amended returns. This provided the total amount of computer-matched and estimated interest payments of under $1 million each that were related to examination abatements or amended returns.

E. For the 40 taxpayers receiving more than $10 million each in interest in FY 1999 (net of all interest reversals posted in FY 1999), we:

1. Obtained and reviewed IRS Masterfile transcripts for all interest payments over $1 million not computer-matched to tax change transactions to manually identify examination abatements or amended returns that caused the payment of the FY 1999 interest.

2. Obtained and reviewed IRS Masterfile transcripts for all interest payments of over $5 million that were computer-matched to tax change transactions to manually verify that examination abatements or amended returns caused the payment of the FY 1999 interest.

3. Conducted account research to identify the 38 corporate taxpayers out of the 40 business taxpayers receiving more than $10 million each in net interest in FY 1999.

   Determined the average age of examination and non-examination refunds using an electronic spreadsheet annuity function that computes the number of years required to produce a desired amount of interest based upon a fixed amount of investment and a fixed interest rate.

   a) The actual total amount of interest refunded in FY 1999 was used as the desired interest amount.

   b) The actual total principal amount from FY 1999 interest-bearing refunds was used as the investment amount.

   c) The average interest rate for large corporate overpayments from FYs 1994 through 1999 (compounded daily) was used as the interest rate.

4. Provided, at the request of the IRS' Large and Mid-Size Business Division, information with which to determine the circumstances surrounding the interest payments of $10 million or more.

5. Conducted account research on the 38 corporate taxpayers receiving over $10 million in FY 1999 interest to identify the 33 corporate taxpayers included in the IRS' Coordinated Examination Program.

III. Evaluated the fairness of post-OBRA 93 interest laws embodied in the I.R.C.

A. Researched Congressional records to determine the reasons cited by the Congress for making various changes to interest laws from Calendar Years 1966 through 1999.

B. Evaluated I.R.C. provisions, Treasury Regulations, Revenue Rulings, IRS operations manuals, and IRS Masterfile computer programming documentation for consistency and equity in the laws and procedures governing the conditions requiring interest payments as well as the computation of interest.

C. Identified inequities caused by the current laws in their attempt to ensure fairness while avoiding profit-motivated abuse of the refund process.

D. Reviewed Congressional testimony by the Joint Committee on Taxation on its study of penalty and interest laws required by the IRS Restructuring and Reform Act of 1998 (RRA 98).[3]

E. Reviewed Congressional testimony by the Tax Executive Institute in response to the Joint Committee on Taxation penalty and interest study.

F. Identified the specific tax law changes needed to provide fairness in interest payments, eliminate profit-motivated abuse of the refund process, and transfer all responsibility for interest payments to the IRS.

[3] Pub. L. No. 105-206, § 3302, 112 Stat. 685 (1998).

Appendix II

Major Contributors to This Report

Gordon C. Milbourn III, Assistant Inspector General for Audit (Small Business and Corporate Programs)
Philip Shropshire, Director
William E. Stewart, Audit Manager
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Appendix III

Report Distribution List

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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Funds Put to Better Use – Potential; $2.6 billion per year.[1] Over 5 years, $13 billion (see page 4).

Methodology Used to Measure the Reported Benefit:
We obtained and analyzed Internal Revenue Service (IRS) reports for Fiscal Years (FY) 1994 through 1999 involving interest payments made following the passage of the Omnibus Budget Reconciliation Act of 1993 (OBRA 93).[2] We secured a Masterfile[3] extract of the 5.9 million interest payments made to 4.8 million taxpayers whose accounts were credited with interest in FY 1999. We determined how much interest was paid in FY 1999 on each category of subsequent return covered by the interest provisions enacted by the OBRA 93. We categorized the FY 1999 interest payments by type of tax and type of taxpayer. We also stratified the interest payments by dollar amount.

We studied the legislative history of the OBRA 93 interest law changes, as well as the legislative histories of several other interest law changes. Through these various analyses, we were able to identify the specific tax law changes needed to provide fairness in interest payments and transfer all responsibility for interest payments to the IRS. In addition, through these general analyses as well as analysis of specific taxpayer records, we were able to determine the critical role of correctly establishing the taxpayer's claim date to ensure fairness for taxpayers whose returns are examined by the IRS.

Under current interest law, interest must be paid to taxpayers for the time period between the filing of an original return and the date of a refund claimed on an amended return or a refund resulting from an IRS examination. We recommend that the IRS seek legislation to eliminate interest for any time prior to a taxpayer request for a refund or credit

[1] This estimate is based on the average amount of interest paid by the IRS over a 6-year period and represents the amount of interest that could be avoided if all overpayments are timely refunded by the IRS within 45 days. Therefore, the actual interest savings would be reduced by an indeterminable amount for any refunds that are not timely processed.
[2] Pub. L. No. 103-66, § 13271, 107 Stat. 312 (1993).
[3] The Masterfile is the IRS' main computer system, containing taxpayer accounts.

application. With such legislation, interest would no longer be mandatory on any refund. The enactment of new legislation, based upon taxpayer and IRS responsibilities and applicable to all refunds, would provide the IRS with the opportunity to eliminate all interest by issuing all refunds within 45 days of identifying an overpayment.

To determine the amount of interest that the IRS could avoid by issuing interest-free refunds within 45 days (assuming successful implementation of the recommended legislation), we relied upon the IRS' Net Tax Refund Analysis Report, Revenue Accounting Control System Report 050, Nationwide Consolidated Interest Report for FYs 1994 through 1999. The report reflects only interest included on refunds issued during a fiscal year and is adjusted for interest cancellations relating to interest payments made during the fiscal year or made in prior fiscal years. The Net Tax Refund Analysis Report provided the following fiscal year interest totals:

Fiscal Year	Interest Amount Paid
1994	$3,092,886,641.32
1995	$2,693,769,898.36
1996	$2,199,591,881.49
1997	$2,370,117,608.19
1998	$2,606,975,956.14
1999	$2,725,027,639.29[4]

FY 1994-1999 Interest Paid	**$15,688,369,624.79**
FY 1994-1999 Average Interest Paid Annually	**$ 2,614,728,270.80**

[4] The IRS credited $3.5 billion in interest to taxpayer accounts in FY 1999, but the lower figures from the IRS' Net Tax Refund reports for FYs 1994 through 1999 are being used for this projection. Although the figures from the Net Tax Refund reports do not include interest credited to accounts until the related refunds are actually issued, they have the advantage of reflecting the multi-year dynamics of the interest payment and abatement process. The multi-year reporting basis produces lower reported interest payments because the payments are reported after subtracting interest reversals related to interest that was credited to accounts in prior years.

Appendix V

Management's Response to the Draft Report

EPUTY COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

RECEIVED
SEP 07 2001

August 30, 2001

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Bob Wenzel
Deputy Commissioner of Internal Revenue

SUBJECT: Draft Audit Report – Tax Law Changes are Needed to Improve Fairness in Paying Interest on Tax Refunds

Thank you for the opportunity to respond to your draft audit report evaluating the complexity and fairness in paying interest on tax refunds. We agree with your concerns that the current interest rules are quite complex and that the issue of fairness is important. In fact, our Office of Penalties and Interest is continuing to work on developing and implementing processes and programs aimed at increasing IRS accuracy in interest administration. These efforts, which are on schedule to be delivered during FY 2002, include:

- The procurement of commercially available interest computation software for use in computing complex interest cases;
- The revision and/or development of new training programs;
- The establishment of a Complex Interest Specialist position and a Complex Interest Quality Measurement System.

Although your draft report raises a number of issues, which we will consider, we are unable at this time to agree to your recommendation that we propose legislation. The responsibility to propose legislation to the Congress is reserved to the Department of the Treasury. However, we will conduct a review with the affected divisions of the IRS and with Treasury, and draft any resulting legislative proposals which the Department approves.

Your recommendations are as follows:

IDENTITY OF RECOMMENDATION 1:

The Commissioner of the IRS should propose legislation regarding the payment of interest that will provide for equal treatment for all taxpayers and place responsibility for all interest paid on the IRS, thus providing the IRS with the ability to eliminate $2.6 billion annually through timely processing.

2

IDENTITY OF RECOMMENDATION 2

The Commissioner of the IRS should propose legislation that will require the same rate of interest be paid to all taxpayers. This will ensure that taxpayers are compensated equally for IRS delays.

The following responds to both recommendations:

ASSESSMENT OF CAUSE

As stated in the report, a number of significant changes to the tax law have occurred since the mid-60s. Chief among these was OBRA 93, and RRA 98, as well as the May/Sequa Tax Court Decision. Each of these actions increased the complexity of interest computation for the IRS and the taxpayer. This complexity is of such a magnitude that some of the tax practitioner firms have established specialized interest units to determine interest on clients' accounts.

CORRECTIVE ACTION

The Commissioner, SB/SE, will coordinate with the other IRS Operating Divisions, the Office of the Chief Counsel, and the Department of the Treasury to review the current interest rules. The final determination of the need for legislation stemming from that review is the responsibility of the Department of the Treasury's Assistant Secretary for Tax Policy.

IMPLEMENTATION DATE

June 1, 2002 (completion of review)

RESPONSIBLE OFFICIAL

Commissioner, SB/SE

CORRECTIVE ACTION MONITORING PLAN

None

If you wish to discuss our response to your draft report, please call Joseph G. Kehoe, Commissioner Small Business/Self-Employed Division, at (202) 622-0600.